

CEBS CONSULTATION ON DRAFT HIGH-LEVEL PRINCIPLES OF REMUNERATION POLICIES

Comments by AMAFI

1. *Association française des marchés financiers* (AMAFI) has more than 120 members representing over 10,000 professionals who operate in the cash and derivatives markets for equities, fixed-income products and commodities. Nearly one-third of the members are subsidiaries or branches of non-French institutions.

2. AMAFI would like first to thank the Committee of European Banking Supervisors to give the stakeholders the opportunity to comment on its draft high-level principles on remuneration policies. The French financial community has taken a particularly early interest in this matter since it issued in February, at the request of the French Minister of the Economy, some guidelines related to the compensation of market professionals, which are designed to align professional behaviours with the long-term objectives of the firms employing them, particularly as regards risks. These guidelines were since approved by the French authorities and, upon request of the Minister of the Economy, are to be implemented by all the institutions concerned by the end of April. In this regard, the competent regulatory and supervisory authorities are required to present to the Minister a report on the actual implementation of these guidelines by the end of May.

In addition, national regulation on internal control in credit institutions and investment firms (CRBF 97-02) was recently amended so that, from end-July onwards, compensation policies of firms are tailored to their risk management objectives.

3. AMAFI approves the general approach favoured by CEBS of addressing, at a high level, the wide range of topics related to the issue of remuneration policies while acknowledging that firms are the best judge ultimately to determine, within the general framework provided by CEBS, the particulars of their remunerations policies that will make them the most suited to their needs and activities. We feel nevertheless that some clarifications are needed in some specific areas because there is a risk of divergent national interpretations, potentially harmful to the competitive level playing field in Europe. We will be detailing these areas of concern in the full body of the answer.

4. Before commenting on the set of principles proposed by CEBS in its consultation paper, AMAFI would like to put forward some general observations.

- There is a need for general principles on remuneration structures to ensure notably that they are consistent with good risk management as regards the firm's business and overall risk tolerance. When elaborating such principles, attention should nevertheless be paid to the very competitive nature of the financial markets and to the European or even global level at which most of the firms operate. It is hence essential that:

- Firms operating in the financial industry remain able to recruit and retain the best competences/skills and not be put at a disadvantage compared with other businesses less (or not) regulated in respect of remuneration but able to attract skilled people from financial firms.
 - Any approach needs to be highly coordinated at the international level by regulators and supervisors.
- The principles are intended to be implemented by all financial institutions, which is good to preserve a level playing field but also creates a risk that the diversity of the firms concerned is not considered, whereas remuneration practices vary a lot among them depending on their businesses or their size, notably as regards their capacity to set up stock options programmes.
- Finally, AMAFI would like to draw CEBS's attention on the potential interaction between European-based principles or any future European legislation and some social provisions of national laws which may restrict or even hinder the firms' ability to modify their current pay arrangements.

SCOPE

5. On paragraph 2 of the consultation paper, we share the view that guidelines should be oriented towards senior employees, other risk-takers and managers. However, it seems neither realistic nor efficient to extend the scope of the remuneration policy to all levels of the organisation and all categories of employees. The focus should not be on employees (and on their levels or categories) but rather on the positions or businesses that expose the firm to significant risks, keeping in mind that the fundamental objective of these principles is the reduction of systemic risk. In particular, firms should be permitted to adopt a risk-based approach instead of having to consider indiscriminately all employees of the firm. It means that it is mainly employees who are in a position to create, manage or control risks, whatever their levels or categories, who should fall within the scope of the principles.

GENERAL

i. The financial institution should adopt an overall remuneration policy that is in line with its business strategy and risk tolerance, objectives, values and long-term interests. It should not encourage excessive risk-taking. The remuneration policy should cover the institution as a whole and contain specific arrangements that take into account the respective roles of senior management, risk takers and control functions. Control functions should also be adequately rewarded to attract skilled individuals.

6. AMAFI agrees with the general approach followed by CEBS, which focuses on remuneration policies rather than on levels of remuneration and which is aimed at ensuring that variable compensation does not result from an exclusive short-term perspective that can lead to excessive risk-taking.

Similarly, we agree with the types of functions requiring specific arrangements in the remuneration policy, which leads us to conclude that CEBS is actually in agreement with our comment made earlier (cf. § 2 of the scope).

7. On control functions more particularly, efficient and independent control functions are a core component of good risk management. Hence, management should ensure that control functions are effectively positioned within the firms to be able to fulfil their duties effectively. In particular, risk management professionals need to have sufficient weight in relation to the front office teams. This weight is undoubtedly a result of their competence and skills (that a proper remuneration can attract), but also and primarily of the support and importance they are given by the upper management of the firm. Consequently, in AMAFI's view, focusing on the appropriate level of compensation of these professionals is less important than ensuring they are properly empowered by the upper management.

ii. The remuneration policy should be transparent internally and adequately disclosed externally.

8. With respect to transparency, AMAFI believes that the focus should be primarily on ensuring that the firm's supervisor have access to all relevant information in order for them to be able to control compliance with the principles, from the consistency of the compensation policy with the firm's risks policy to the adequacy of remuneration agreements in place.

9. As far as CEBS' proposed principle is concerned, AMAFI fully agrees that all employees should know in advance the criteria that will be used to determine their remuneration. However, disclosure of a firm's remuneration policy to internal and external stakeholders must be sufficiently general not to jeopardise commercial confidentiality and the privacy of individuals. We therefore suggest that the transparency and disclosure recommended be limited to the general principles of the policy.

In any case, this principle should be worded precisely to ensure it does not leave room for interpretation by national regulators, which would without any doubt be detrimental to the European level playing field.

GOVERNANCE

iii. The management body, in its supervisory function, should determine the remuneration of the management body, in its management function. In addition it should have oversight of the overall remuneration policy of the firm. The implementation of the remuneration policy should be subject to central and independent review.

10. AMAFI would like to highlight the particular importance of corporate governance when discussing remuneration policy. Indeed, firms' management should define a framework within which remuneration policies shall be set and monitored for each entity. When the size of the firm justifies it, a dedicated remuneration body such as a remuneration committee should play a central role for establishing and monitoring the policy. It should be informed of its application at individual level above a certain threshold set by the company. The independent and central review of the policy referred to in this principle could be adequately performed by an internal body such as the audit department. In all events, it would appear excessive to require that central and independent review be carried out by independent consultants.

MEASUREMENT OF PERFORMANCE AS A BASIS FOR REMUNERATION

iv. Where the pay award is performance related, remuneration should be based on a combination of the individual performance's assessment, the performance of the business unit and the overall results of the company or group. When defining the individual performance other factors apart from financial performance should be considered. The measurement of performance, as a basis for bonus awards, should include an adjustment for risks and cost of capital.

11. AMAFI supports CEBS approach on the measurement of performance when used as a basis for remuneration. Performance-related compensation should indeed be linked to the performance of the team and the company in addition to the performance of the individual. Evaluation criteria at the individual level should also include qualitative ones, notably as regards compliance with the firm's internal policies and procedures. Generally speaking, the full set of criteria must help dissuade employees from taking risks above the level that the company deems acceptable.

Also, the practice of guaranteed bonuses, which by nature are not performance related, should be prohibited for the future except for new hires or to retain individuals in key positions, in which case the guarantee should not exceed more than twelve months.

FORM OF REMUNERATION

v. There should be a proportionate ratio between base pay and bonus. Where a significant bonus is paid, the bonus should not be a pure upfront cash payment but contain a flexible, deferred component; it should consider the risk horizon of the underlying performance.

12. Rather than a proportionate ratio between base pay and bonus, one should focus on the level of the base pay, which should be sufficient to remunerate the competency and experience of the professional and to assure him or her a proper standard of living. This is so because situations vary substantially depending on the business and the position concerned. Hence, it does not seem possible to set any optimal ratio between the fixed and performance-related components of the compensation, its "optimal" character for some being non optimal for others.

In addition, it does not seem realistic nor appropriate to state in these principles aimed at employers that employees should think in a certain way ("*employees should not have to rely on bonuses*"). We agree however that firms should make sure they communicate clearly and openly about the variability and unpredictability of bonuses and the possibility that they could be nil.

Finally, a few words used in this section of the principles have a very general meaning that makes them subject to divergent interpretations, creating again a risk of distortion. For example, one could wonder what is the threshold for qualifying a bonus as "big"...

